



Budget Statement 2016: Key Takeaways

Chancellor George Osborne delivered his annual Budget speech yesterday. While there are winners and losers as usual, this year's Budget can be considered quite favourable to middle income families and savers. The pension tax relief is safe (for now) and Capital Gains Tax goes down, among other things. Whilst the Budget contained a wide range of measure, our analysis concentrates on those aspects, which are most important to our clients, namely, taxes, pensions and investments. The full speech is available [here](#).

Personal Allowance and Higher Rate Threshold Up

The Personal Allowance, which is the amount you can earn without having to pay Income Tax, will increase from the current £10,600 to £11,000 for the 2016-17 tax year and £11,500 for 2017-18 (up from the previously announced £11,200).

The higher rate threshold will rise from the current £42,385 to £43,000 for 2016-17 and £45,000 for 2017-18. It is estimated that about 585,000 taxpayers will fall out of the 40% tax bracket as a result.

Both of these are in line with the Government's previous promises to increase the Personal Allowance to £12,500 and the higher rate threshold to £50,000 by April 2020.

Pension Tax Relief Remains

The fears of pension tax relief cuts or other radical changes to the existing pensions system have not materialised, at least for now. In light of the loud opposition to these plans, pointing out that such measures would discourage people from saving for retirement, the Chancellor has decided to not proceed at this point. The only reference in his speech was the following:

"Over the past year we've consulted widely on whether we should make compulsory changes to the pension tax system. But it was clear there is no consensus."

Of course, this does not mean the issue is safely off the table forever. The Chancellor still needs to find ways to meet his goal of "surplus by 2019-20" and pensions certainly remain among the possible targets. For the 2016-17 tax year though, the allowance stays at £40,000 (for those earning under £150,000), with pension tax relief equal to your marginal tax rate. As previously announced, the Lifetime Allowance falls to £1m effective from April 2016.

ISA Allowance £20,000 and New Lifetime ISA

While pensions have been subject to shrinking allowances in the last years, the trend has been the opposite with ISAs, apparently one of the Government's preferred ways for people to save for retirement. This time the Chancellor has announced that the annual ISA allowance would jump to £20,000, although only from April 2017. For the 2016-17 tax year the allowance remains at £15,240, same as this year, as previously indicated.

A completely new type of ISA will be introduced in April 2017, called Lifetime ISA. Young savers will be able to contribute up to £4,000 a year and receive a 25% bonus from the Government. That is extra £1 for every £4 saved, a maximum of £1,000 per year. You must be under 40 when opening the account; you will be entitled to the bonus every year up to the age of 50, but only if you have opened

an account before 40 (therefore those reaching 40 before 6 April 2017 will miss out). Furthermore, to qualify for the bonus the money must only be used either to save for retirement or to buy a home. If you withdraw cash before the age of 60 and use it for purposes other than buying a home, you will lose the bonus (including any returns on it) and pay a 5% penalty.

The Lifetime ISA is intended as an alternative to pensions for young workers (“many of whom haven’t had such a good deal from the pension system”) and will most likely further develop in the next years. With its home ownership objective it will replace the previously announced Help to Buy ISA, which remains in place until 2019 and can be transferred to the new ISA after April 2017.

Capital Gains Tax Down (Excluding Property)

Shares and other investments sold outside an ISA or pension scheme are subject to Capital Gains Tax when the annual CGT allowance (currently £11,100) is exceeded. As another welcome change to investors, the rates of CGT will drop from 18% to 10% (basic rate) and from 28% to 20% (higher rate).

Importantly, these reductions won’t apply to capital gains from property sales, which will continue to be taxed at the existing rates. This is consistent with the Government’s recent actions against Buy to Let and intended to “ensure that CGT provides an incentive to invest in companies over property”.

Other Changes

The following are some of the other announcements from this year’s Budget speech.

- From April 2017 there will be two new tax-free allowances (£1,000 each) to support micro-entrepreneurs and the “sharing economy”. The first will apply to property income (such as when renting out your home), the other to trading income (such as when occasionally selling goods and services online).
- Corporation Tax will decrease further than previously announced, to 17% from April 2020.
- Contrary to expectations, fuel duty will continue to be frozen for sixth year in a row.
- From April 2018 there will be a new levy on soft drinks with high sugar content. The proceeds will help finance more PE and sport in schools.
- Last but not least, Armed Forces veterans in need of social care will be able to keep their war pensions, rather than use them to pay for care.

Conclusion

For the time being, pensions remain the primary way to save for retirement and their tax and other advantages are hard to beat by the alternatives, even with the reduced CGT. Their major downsides are the reduced Lifetime Allowance and Annual Allowance for high earners, effective from 6 April. Of course, further changes may come in the next months and years.

With 25% bonus from the Government, the new Lifetime ISA offers attractive net returns, as long as you meet the conditions. It is only £4,000 per year, but that could add up and compound over time. Even if you are too old to qualify yourself, make sure your children know and take advantage of it when it starts to be available in April 2017.

Lastly, if you are likely to exceed the CGT allowance, consider deferring the sale until 6 April where possible. Not only you will have a new allowance to use, but also CGT rates will be lower by 8 percentage points if you exceed it.